BUSINESS, LABOR & ECONOMIC AFFAIRS
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DATE 2-20-07
BILL No. SB455

MONTANA FINANCIAL SERVICE

CENTERS ASSOCIATION

FACTS ABOUT

DEFERRED DEPOSIT AND

SENATE BILL 455

How does the cost of a deferred deposit loan compare to the common alternatives?

CREDIT ALTERNATIVE	$100 DEFERRED DEPOSIT LOAN	$100 OVERDRAFT BANK FEE	CREDIT CARD LATE FEE ON $100 BILL	LATE/DISCONNECT FEE ON $100 UTILITY BILL	$100 BOUNCED CHECK NSF/MERCHANT
Fee	$15.00	$27.40	$37.00	$46.16	$54.04
APR	391%	701%	965%	1204%	1409%

Sources: Avg. NSF fee $27.40 (Bankrate.com, Fall 2006); Avg. merchant returned check fee $26.64 (2006 CFSA fee survey); Avg. utility late and reconnect fee (2006 CFSA fee survey); Avg. credit card late fee (Credit Cards: Increased Complexity in Rates and Fees, Government Accountability Office, 2006); Avg. overdraft protection fee (Bankrate.com 2005); Typical payday advance fee (CFSA).

Customers have alternatives to deferred deposit loans but choose a deferred deposit loan because it is more economical than the alternatives.

How would Senate Bill 455 affect consumers and the Montana economy if it were to pass?

- Hundreds of jobs would be eliminated across the state due to business closures. Many of the jobs eliminated provide health benefits, dental benefits and retirement plans.
- Thousands of consumers would lose the option of obtaining a deferred deposit loan to help in a time of need and consequently would be driven to use more costly alternatives such as overdraft protection, bounced check fees, late fees and possibly unregulated out-of-state or off-shore internet lenders. Ultimately consumers are hurt rather than protected.
- Senate Bill 455 eliminates less expensive deferred deposit loans as an alternative to responsible consumers, because of the abuse of this credit product by a small number of borrowers.

What laws and rules are currently in place for regulating lenders in the State of Montana?

- The maximum loan amount is $300
- Loans cannot be refinanced or rolled over
- The maximum fee allowed is 25 percent of the loan amount
- Consumers have the right to rescind (cancel) the loan at no charge to them, by 5 PM the business day following the loan
- A criminal background check must be performed on every employee working at a lenders office
- Complete disclosures on terms, fees and APR's must be disclosed clearly and completely in accordance with Federal regulation Z
- Every office is examined by the state on an annual basis to ensure complete compliance with all laws and regulations
- A brochure is given to every customer with cautions and recommendations regarding obtaining a loan. Also included is a phone number for the Montana Division of Banking and Financial Institutions.

Senate Bill 455 would hurt Montana consumers, small business, and the economy.

<u>Please Vote No on Senate Bill 455.</u>

CFSA

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Federal Reserve Bank of New York Staff Study: Payday loans do not meet the definition of "predatory".

A forthcoming study, *"Defining and Detecting Predatory Lending,"* by Donald P. Morgan, Research Officer, Federal Reserve Bank of New York, and Samuel G. Hanson, Graduate Student, Harvard Business School, concludes that payday loans are not a "welfare reducing" form of credit. To the contrary, the authors suggest that payday lenders enhance the welfare of households by increasing the supply of credit.

Noting the difficulty in defining "predatory," the authors set out to distinguish predatory lending from "the kind that helps households maintain consumption even as their incomes fluctuate." They examined differences in household debt and delinquency across states that allow payday lending and those that do not and compared the change in those differences before and after the advent of payday lending. Particular attention was paid to households that seem more vulnerable to predation (those with income uncertainty or less education).

Noted in the report:

Payday loans are not welfare reducing, or "predatory"

"We define predatory lending as a welfare reducing provision of credit."

"Our findings seem mostly inconsistent with the hypothesis that payday lenders prey on, i.e., lower the welfare of, households with uncertain income or households with less education."

"On the whole, our results seem consistent with the hypothesis that payday lending represents a legitimate increase in the supply of credit, not a contrived increase in credit demand."

Payday loans may enhance the welfare of households

"Credit delinquency rates are not higher for households in states with higher payday loan limits."

"Households with uncertain income who live in states with unlimited payday loans are less likely to have missed a debt payment over the previous year... consistent with claims by defenders of payday lending that some households borrow from payday lenders to avoid missing other payments on debt."

"Those types of households who happen to live in states that allow unlimited payday loans are less likely to report being turned down for credit, but are not more likely, by and large, to report higher debt levels..."

Price does not make payday loans "predatory": limiting access raises prices

"Higher prices are neither necessary nor sufficient to conclude that a certain class of credit is predatory."

"We find somewhat lower payday prices in cities with more payday stores per capita, consistent with the hypothesis that competition limits payday loan prices... The problem of high prices may reflect too few payday lenders, rather than too many."

"Before payday lending... very small, short-term loans may not have been worthwhile for banks. Payday lending technology may have lowered those fixed costs, thus increasing the supply of credit... That suggests the payday innovation was welfare improving, not predatory."

UNC-Greensboro Economist Challenges DoD Study on Payday Loans
Thursday September 14, 10:46 am ET

Dr. William Brown Testifies at Senate Banking Hearing Today

WASHINGTON--(BUSINESS WIRE)--Sept. 14, 2006--The Consumer Credit Research Foundation announced today that Dr. William Brown, Jr., an Associate Professor in the Department of Accounting and Finance at the University of North Carolina at Greensboro, is testifying on Capitol Hill today before the U.S. Senate Committee on Banking, Housing and Urban Affairs during "A Review of the Department of Defense's Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents."

Dr. Brown is the co-author of an important academic study on this topic, "Payday Loan Attitudes and Usage Among Enlisted Military Personnel," which was released on June 27, 2006. Dr. Brown will review the key findings from the first of its kind empirical study of the short term credit needs of U.S. Military enlisted personnel, as well as review the methodology and scholarship of the DoD report.

The following is his testimony:

Chairman Shelby, Senator Sarbanes and members of the Committee, thank you for the opportunity to speak to you today about the Department of Defense's report on lending practices directed at members of the armed forces. I am currently an Associate Professor in the Department of Accounting and Finance at the University of North Carolina at Greensboro and an economist by training. Over the past two years I have conducted research on payday lending, military compensation and the use of payday loans by military personal. In June of this year, I released a study with my colleague, Dr. Charles B. Cushman, Jr. from The George Washington University, of payday loan attitudes and usage among enlisted military personnel. Our results are cited on several occasions in the Department of Defense Report.

I would like to take this opportunity to share with you some of our key findings and then raise some of my concerns about the methodology and analysis in the recent Department of Defense report. Our study surveyed U.S. enlisted personnel in four branches of the armed services regarding their attitudes toward, and usage of, short-term credit, including payday loans. Our survey is the first systematic survey of enlisted military personnel regarding their economic circumstances and attitudes toward short-term credit. Our analysis is based on empirical data that we collected through a random sample of enlisted military personnel who live near military bases in the United States.

I want to briefly discuss some of our findings that I believe are relevant to the discussion today. Our results indicate that 13% of the 460 enlisted personnel that lived around military bases and responded to our survey had obtained payday loans in the previous year. It is important to note that these numbers are only for enlisted personnel and not all military personnel. It is suggested in the Department of Defense report and elsewhere that our number indicates a higher incidence of payday loan use by members of the military than the general population. However, our results do not provide such a comparison. One would need to compare enlisted personnel with a civilian population of similar age and income in order to make such a comparison. Otherwise, it is an apples to oranges comparison.

Military borrowers report that they use payday loans to help pay bills, for auto and home repairs, family emergencies, relocations and other short term cash flow disruptions. This usage is very similar to that reported by civilian users of payday loans.

The military enlisted personnel who have had a payday loan repay them more quickly than their civilian counterparts. Forty-nine percent of military payday loan borrowers have had two or fewer loans in the last 12 months, and 78% have had four or fewer loans. A 2001 study indicated that only 35% of civilian payday loan users had fewer than four loans. There is little evidence that military users of payday loans use these loans as a substitute for longer term credit. Given the relative low overall default rate for such loans in general, the claims of some opponents to payday lending that payday loans are a threat to military readiness appear unsupported.

Payday loans are but one form of short-term credit available to military personnel. Bounced-check fees, late fees and utility reconnect fees can be and are often more costly than a payday loan. The majority of military survey respondents reported that they choose a payday loan for convenience related reasons. In addition some military personnel reported a lack of alternative options or lack of knowledge about alternative sources of short term loans indicating that the military may need to do a better job of educating enlisted personnel about short term credit options.

As potential decisions regarding the cost and availability of consumer credit by members of the armed services are considered today, I sincerely believe that our comprehensive study, which I have only briefly reviewed here today, would be a valuable body of information to inform your views on this topic. For this reason, I am submitting a copy of our full study for the record today.

As to the Department of Defense report, I have several points of concern and disagreement with the conclusions drawn.

From anecdotes portrayed in the news media and mentioned in the Department of Defense report, one could have the impression that the majority of military personnel are deep in debt, the victims of aggressive payday loan issuers. I am sure many of the anecdotal stories are true. However, anecdotes only tell us what can happen in some cases, they fail to give us a bigger picture view or tell us how often these things happen. There is nothing in the Department of Defense report to give any indication of the prevalence of problem borrowing by military personnel.

There are certainly some military personnel with financial problems and service members with financial problems may have obtained payday loans, but there is no evidence that payday loans are the cause rather than a symptom of these financial problems. This causation connection is completely missing in the Department of Defense report.

Consumers make purchasing decisions based on a number of factors: price, convenience and opportunity being chief among them. This Department of Defense report fails to consider that service members either choose payday loans either because of they lack a better alternative or because they lack available information about better alternatives. In either case, the Department of Defense needs to do a better job of working with financial service firms to provide products that meet the needs of military personnel and educating military personnel about the availability and use of those products.

Finally, the Department of Defense's recommendation to reduce the maximum permissible charge on payday loans to 36% would likely drive lenders out of the market. The problem is that marginal cost of providing small consumer loans is high. This is why so many banks and financial service firms fail to provide such products. When you take choices away from consumers, prices go up, not down. Again, members of the military have a demonstrated need for access to short-term credit. The likely impact of such a rule would be to make military personnel with short term credit needs significantly worse off.

Mr. Chairman and members of this Committee, I thank you for the opportunity to appear before you and will be happy to answer any questions you may have.

About Consumer Research Foundation

As a non-profit organization, exempt under Section 501(c) (3) of the Internal Revenue Code, Consumer Credit Research is dedicated to growing and building a reliable set of research and data on the availability of consumer credit, the industry that provides credit services, the consumers that use them and the local, state and federal officials who oversee these services. We believe that many of the issues around the availability of consumer credit are in need of better public discourse about the products and services lenders provide and how those consumers go about making informed, rational choices as they secure and use credit. Visit Consumer Credit Research Foundation online at www.consumercreditresearchfoundation.org.

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From: American Banker
Friday, January 26, 2007
Letter to the Editor: Pentagon's Rate Cap Should Be Universal

To the Editor:

The very public attempt by five banking trade associations to influence the Defense Department's guidance on rate caps for credit products offered to members of the armed forces ["Making a Case to the Pentagon," Jan. 8, and "Focus on Payday Lenders, Pentagon Urged," Jan. 9] provides an excellent opportunity to watch how the Defense Department protects the men and women who protect this country.

If the 36% annual percentage rate cap, including fees, contained in the 2006 Defense authorization bill is a reasonable measure to protect military personnel and their families from abusive financial products, then the Defense Department will apply it to all providers. To do otherwise would defeat the protective purpose of the restriction.

Exempting banks, credit unions, credit card issuers, mortgage lenders, and other consumer credit providers from the restriction would continue to leave military personnel vulnerable to products and services with rates deemed to be harmful in the new legislation.

If the Defense Department accepts the suggestions of the five trade associations, it will substantially improve the financial industry's position over military personnel, rather than the other way around.

There appears to be little reason to grant such preferential treatment to these financial institutions. After all, if on-base banks and credit unions provided military personnel easy access to small-dollar-value, short-term, unsecured loans, there would be no need for them to patronize off-base payday lenders in the first place.

The Pentagon is about to become a financial services regulator — much to the chagrin of those who just a few months ago happily invoked the specter of national security when they thought it would eliminate competitors.

This budding regulator has now received guidance from trade associations representing a large segment of the population to be regulated (banks) seeking to divert enforcement of the coming restrictions solely on to a small segment of the regulated population (payday advance companies) because of its supposedly high-cost products.

But their action implies that high-cost products and services emanate solely from this segment — which is simply not true.

A 2000 Defense Department report exposed abuses of military personnel by the insurance industry, especially the sale of complex, high-commission, insurance-based investments to recruits, often in their barracks. Although the report called for greater regulation of insurance companies or a total ban on selling life insurance on base, the Pentagon caved in to industry pressure and let the subject drop.

In the fall of 2004 the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises hearing "G.I. Finances: Protecting Those Who Protect Us," revisited the same issue. The hearing focused special attention on products sold to vulnerable recruits with commissions that consumed 50% of first-year contributions.

A 2005 report by the Consumer Federation of America highlighted exorbitant bank overdraft fees and how so-called bounce protection programs turned ATM debit cards into the most expensive cards in the market, largely without cardholders' knowledge.

In her groundbreaking research of the payday loan marketplace in 2005, FDIC Chairman Sheila Bair, then a professor at the University of Massachusetts at Amherst, found that although the demand for small, short-term loans was growing explosively, few banks and credit unions were making such loans to their depositors. Ms. Bair concluded that financial institutions did not want to offer small loans which might cannibalize the huge revenue from overdraft protection programs generating fees of $17 to $35 per item.

She also recommended that these depository institutions should be required to disclose the cost of such credit extensions to consumers, rather than be allowed to hide behind selectively applied regulation.

Just last month Sen. Christopher Dodd spoke of his continuing concern about high-rate loans and promotional offers from credit card companies and mortgage lenders that he said even some bankers agreed were "outrageous." He announced, "Some of the practices being used by the banking community are going to be stopped on my watch."

Both Sen. Dodd and Rep. Barney Frank have been outspoken critics of predatory lending and racial biases at banks and mortgage companies. Sen. Dodd is known to refer to credit cards as pocket-size predatory loans.

The U.S. military is deployed throughout the world to protect a variety of liberties, including freedom of choice. It would be hard to believe that the Pentagon could come out against this freedom for members of the armed forces here at home.

If the Defense Department simply directed financial service providers, many of whom enjoy preferred on-base locations, to abide by the 36% rate cap for credit products when serving military personnel, it should reduce the need for off-base payday lenders and eliminate the need for further legislation, regulation, and/or guidance.

Everyone serving the financial needs of military personnel should agree to play by the same rules. And these rules should ensure that no military family is at risk of being victimized by high-rate credit.

In the coming months the Defense Department will have the opportunity to demonstrate its responsibility for the financial well-being of the men and women who serve our nation. It will either decide to protect military personnel from high-rate credit products it believes are harmful, or it will protect banks, credit unions, credit card companies, insurance companies, and mortgage companies from outside competition.

The rest of us will have the opportunity to see whose side the Defense Department is on.

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Editor's Note: The author of the above article is a retired Marine Corps officer.

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